91-1777

No. ____

Supreme Court, U.S.
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# In The Supreme Court Of The United States

OCTOBER TERM, 1991

AMWEST SURETY INSURANCE COMPANY,

*Petitioner,*

v.

UNITED FIDELITY & TRUST CO.,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

1. Which, of two claimants, is entitled to be paid first from monies which the United States Government holds as stakeholder on a completed federal construction contract: a bonding company which paid claims against the bond which it had issued on the contract pursuant to the Miller Act (40 U.S.C. §270a, et seq.), or a commercial lender which made loans to the contractor and which claims an assignment of the contract pursuant to the Assignment of Claims Act (31 U.S.C. §3727, 41 U.S.C. §15)?

The Miller Act requires that a qualified surety issue payment and performance bonds for most Federal construction contracts, assuring that the work will be completed and that

suppliers of labor and material will be paid as required by the contract. The Assignment of Claims Act provides a mechanism whereby financial institutions may claim an assignment of the payments to become due on Federal contracts, as security for loans made to the contractor.

Amwest Surety Insurance Company ("Amwest Surety") paid claims that were made against a bond which had been issued by Amwest pursuant to the Miller Act. Amwest Surety then asserted that it was entitled to recover its losses from contract payments which were to come due on the bonded contract, based on principles of equitable subrogation. However the contractor had also defaulted on certain loans which had been made to it by United Fidelity &

Trust Company ("UFTC"). UFTC claimed an interest in the bonded contract as an assignee pursuant to the Assignment of Claims Act. After the bonded contract was completed, the contractor filed a bankruptcy case in the Eastern District of Louisiana, and the Government subsequently interpled the remaining balance which was due under the contract.[1]

The United States Claims Court (based on principles which clearly have been adopted by the United States Court of Appeals for the Federal Circuit) has

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[1]The Internal Revenue Service of the U. S. Government also claimed an interest in the funds. Both Amwest Surety and UFTC conceded that the I.R.S. would be paid first under whichever theory was applied, and the dispute now concerns who shall be paid first from the balance remaining after payment of the I.R.S.

ruled, on substantially similar facts, that the surety's equitable claim is superior to that of the assignee lender. The United States Court of Appeals for the Fifth Circuit has now ruled directly to the contrary in the present case. The consequence is that a long-existing conflict between Federal jurisdictions concerning the result under these circumstances has been reinforced and re-emphasized.

## LIST OF PARTIES

The parties are the Petitioner, Amwest Surety Insurance Company, and the Respondent, United Fidelity & Trust Company.[2]

In the Bankruptcy Court proceedings below, River Products, Inc., and the Internal Revenue Service were also named parties. Neither of these parties has an interest in the outcome of this proceeding, neither participated in the case below in the Court of Appeals, and therefore, neither are named as parties herein.

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[2]Amwest Surety Insurance Company is a California corporation qualified to do business as a commercial surety in all 50 states. Its stock is publicly traded. Amwest Insurance Group, Inc., is a parent corporation, and Far West Insurance Company is an affiliate.

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**IN THE SUPREME COURT OF THE UNITED STATES**

OCTOBER TERM, 1991

AMWEST SURETY INSURANCE COMPANY,
Petitioner,

v.

UNITED FIDELITY & TRUST CO.,
Respondent.

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT
OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner, Amwest Surety Insurance Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, rendered in the above-styled proceeding on February 5, 1992.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit, styled **In The Matter of River Products, Inc., Debtor, United Fidelity & Trust Company, Appellee, versus Amwest Surety Insurance Company, Appellant,** case number 91-CV-1303, affirming the decision of the United States District Court for the Eastern District of Louisiana is reproduced in Appendix A (1A-2A).

The order and reasons of the United States District Court for the Eastern District of Louisiana, styled **In Re: River Products, Inc., Debtor, United Fidelity and Trust Company, Plaintiff versus River Products, Inc., Amwest Surety Insurance Company, and the United States of America, Defendants,** case

number 91-1303, reversing the decision of the United States Bankruptcy Court for the Eastern District of Louisiana is reproduced in Appendix A (3A-7A).

The Judgment, Findings of Fact and Conclusions of Law of the United States Bankruptcy Court for the Eastern District of Louisiana, styled **In The Matter of River Products, Inc., Debtor, United Fidelity & Trust Company, Plaintiff, versus River Products, Inc., Amwest, Inc. and United States of America, Defendants,** bankruptcy number 89-13649B, adversary number 90-1021B, Chapter 11, granting Petitioner's Motion for Summary Judgment, and denying Respondent's Motion for Summary Judgment is reproduced in Appendix A (8A-15A).

## JURISDICTION

The United States Bankruptcy Court for the Eastern District of Louisiana entered its decision on February 28, 1991, holding that Petitioner Amwest Surety was entitled to recover its bond losses from the remaining contract funds on the Debtor's Federal contract, which Amwest had bonded, because Amwest Surety's claim based on its equitable standing as a surety was superior to the claim of Respondent UFTC as an assignee.

UFTC appealed to the United States District Court for the Eastern District of Louisiana, which reversed the Bankruptcy Court in an opinion entered July 31, 1991.

Amwest Surety appealed to the United States Court of Appeals for the Fifth Circuit, which affirmed the District

Court in a decision entered February 5, 1992. No petition for rehearing was sought, and no stay of the mandate has been issued. However, the confirmed bankruptcy plan of River Products, Inc., under Chapter 11, Title 11 of the U. S. Code, provides that the proceeds of the contract which is the subject of this litigation shall not be disbursed until an order determining the priority of the parties' interests is final and non-appealable.

The jurisdiction of this Court to review the judgment of the Court of Appeals for the Fifth Circuit is invoked under 28 U.S.C. §1254(1).

## STATUTES INVOLVED

1. The Assignment of Claims Act, 31 U.S.C. §3727, 41 U.S.C. §15, is reproduced in Appendix A (26A,30A).

2. The Miller Act, 40 U.S.C. §270a, et seq., is reproduced in Appendix A (28A-29A).

## STATEMENT OF THE CASE

Petitioner Amwest Surety Insurance Company (hereinafter "Amwest Surety") is a commercial surety qualified to issue bonds under the Miller Act, 40 U.S.C. §270(a), et seq. In March, 1989, Amwest Surety, as surety, issued Miller Act bonds for a federal contract to be performed by a company called River Products, Inc. The bonded contract was by and between River Products, Inc., and the United States Corps of Engineers, Mobile District, and was identified as

Dredging Contract Number DACW01-89-C-0078 (the "Columbus Lake Contract").

On or about April 17, 1989, River Products, Inc., executed an assignment of the payments due to be earned on the Columbus Lake Contract in favor of Respondent, United Fidelity and Trust Company (hereinafter "UFTC"). UFTC subsequently delivered a notice of assignment to the Corps of Engineers claiming rights in anticipated contract payments pursuant to the Assignment of Claims Act, 31 U.S.C. §3727, 41 U.S.C. §15. River Products, Inc., began work on the project, with UFTC advancing funds to it under a revolving credit arrangement in amounts which eventually totalled $167,053.68 in the aggregate. These loans were not repaid by River Products, Inc. During its prosecution

of the work on the bonded contract, River Products, Inc., failed to pay its subcontractors and suppliers, and as a result, Amwest Surety paid approximately $150,204.00 in settlement of claims against its bond. Prior to completion of the Columbus Lake Contract, River Products, Inc., also became delinquent in payment of taxes due the Federal Government.

The bonded contract was eventually completed, though a dispute arose between River Products, Inc., and the Corps of Engineers concerning the amount of additional compensation which might be due under the contract for changes in the work. On September 26, 1989, after the contract was completed, but prior to resolution of the dispute with the Corps of Engineers over compensation, River

Products, Inc., filed a Chapter 11 bankruptcy case in the Bankruptcy Court for the Eastern District of Louisiana.

After the filing by River Products, Inc., of its bankruptcy case, River Products and the Corps of Engineers reached an accord as to the amount of compensation due under the contract. However this amount was less than the aggregate amount of the claims asserted by the Internal Revenue Service, Amwest Surety, and UFTC, each of which claimed to be entitled to recover payment from the balance of the contract funds. On January 23, 1990, UFTC filed an adversary proceeding in River Products' bankruptcy case against River Products, Amwest Surety, and the United States, seeking to recover the balance of the compensation due under the bonded

contract, and to have the Bankruptcy Court determine the priority of the competing interests which had been asserted with respect to the fund. The Government answered and paid the balance due on the bonded contract into the registry of the Clerk of the Bankruptcy Court, but also asserted a separate claim against the fund for recovery of taxes owed by River Products. Amwest responded by claiming a priority interest as a surety which has incurred losses on its bond.

Eventually both Amwest Surety and UFTC conceded that the Government was entitled to recoup the amount of the unpaid taxes due it ahead of any other recovery from the bond. Amwest Surety and UFTC filed opposing motions for summary judgment to determine which of

them would be paid first after payment of the back taxes due the Government.[3] Amwest Surety argued that, as a surety which had suffered losses under its bond, its interest related back to the issuance of the bond to defeat the interest of the contractor's assignee. Amwest Surety relied upon seminal United States Supreme Court cases to establish the nature of its interest, and recent decisions from the Federal Circuit to

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[3]The balance of the contract proceeds was insufficient to pay both Amwest Surety and UFTC, meaning that one of them would be treated as an unsecured creditor, in part, in River Products' bankruptcy case, and thus would not be paid in full. Additionally, River Products was able to utilize $100,000.00 of the fund as cash collateral, and the last-position claimant against the fund will be relegated to accepting installment payments over three years under the reorganization plan as satisfaction of the secured portion of its claim.

show how that interest should be enforced. Prairie State Bank v. United States, 164 U.S. 227, 17 S.Ct. 142, 144, 41 L.Ed. 412 (1896); Pearlman v. Reliance Insurance Company, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed. 2d 190 (1962); Balboa Insurance Company v. United States, 775 F.2d 1158 (Fed. Cir. 1985); and Reliance Insurance Company v. U.S., 15 Cl.Ct. 62 (1988). The Reliance decision, in particular, was emphasized by Amwest Surety as having been decided on virtually identical facts.

UFTC relied upon two decisions from the Fifth Circuit in opposing Amwest Surety's claim: Coconut Grove Exchange Bank v. New Amsterdam Casualty Company, 149 F.2d 73 (5th Cir. 1945), and its progeny, General Casualty Company v. Second National Bank of Houston, 178

F.2d 679 (5th Cir. 1950). (These cases are hereinafter sometimes referred to as "Coconut Grove" and "General Casualty Company" without additional elaboration.) In these cases, under factual scenarios which Amwest Surety argued were distinguishable, the Fifth Circuit Court of Appeals had concluded that the claim of the surety should be equitably subordinated to the claim of the assignee, at least under some circumstances.[4]

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[4]Amwest Surety argued below that the Coconut Grove and General Casualty Company decisions are distinguishable on their facts from the present case. Amwest Surety also argued that UFTC could not enforce its assignment against Amwest because UFTC had failed to give Amwest contemporaneous notice of the claim of assignment as required by the statute and applicable regulation. UFTC argued that Amwest Surety was estopped from claiming adversely to UFTC because of statements alleged to have been made to UFTC by Amwest's counsel. None of

The Bankruptcy Court (Honorable T. M. Brahney, III) entered a judgment in favor of Amwest Surety on the issue of priority in the contract funds, based largely on the strength of the rationale set forth by the Claims Court in the Reliance opinion. On UFTC's appeal, the District Court (Honorable Marcel Livaudais, Jr.) reversed the judgment of the Bankruptcy Court, holding that the decisions in Coconut Grove and General Casualty Company constituted binding Fifth Circuit precedent. Amwest Surety appealed, and the Court of Appeals for the Fifth Circuit summarily affirmed the District Court, again citing the Coconut Grove and General Casualty Company decisions.

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the courts below addressed any of these issues in their opinions.

## REASONS FOR GRANTING THE WRIT

I. THE FIFTH CIRCUIT'S DECISION THAT AN ASSIGNEE TAKES PRIORITY OVER A SUBROGATED MILLER ACT SURETY IN RECOVERING ITS LOSSES FROM CONTRACT FUNDS PUTS THE FIFTH CIRCUIT AT ODDS WITH THE CLEAR MAJORITY OF FEDERAL JURISDICTIONS, INCLUDING PARTICULARLY THE FEDERAL CIRCUIT, IN WHICH THE CLAIMS COURT HAS RULED ON ESSENTIALLY IDENTICAL FACTS THAT THE SURETY PREVAILS.

The competition between a Miller Act surety and an Assignment of Claims Act assignee, both attempting to recover their respective losses from an insufficient contract fund, is not a new

one. Moreover, the conflict between Federal jurisdictions regarding the outcome of that competition is also of long standing.

The body of modern Federal law in general concerning the rights of a performing surety under a contract bond finds its origin in the case of Prairie State Bank v. U.S., 164 U.S. 227, 17 S.Ct. 142, 41 L.Ed. 412 (1896). The Prairie State Bank opinion was obviously a part of the law at the time that the Fifth Circuit Court of Appeals rendered its decisions in Coconut Grove and, later, General Casualty Company. However Prairie State Bank was not the Supreme Court's final word on the matter. In 1962, some twelve years after the latest of decisions by the Fifth Circuit, the Supreme Court

reaffirmed the primacy of the surety's position in a case involving performance by a surety under a payment bond. In Pearlman v. Reliance Insurance Company, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed. 2d 190 (1962), competing claims by a surety and a bankruptcy trustee were resolved in favor of the surety based on the traditional equity of subrogation. Other Federal jurisdictions followed the Supreme Court's lead in establishing the priority of the Miller Act surety's claim to recover its losses from contract funds on bonded Federal projects. Cf., Anno., Modern Status and Application of Rule That Only Voluntary Transfer or Assignment of Claim Against United States Is Within Assignment of Claims Act, (31 U.S.C.S. §203, 41 U.S.C.S. §15), 44 A.L.R. FED. 775, at

Section 14, pp. 807-810. Until the present case, the Court of Appeals for the Fifth Circuit had not expressly cited the Coconut Grove or General Casualty Company cases in a number of years, and occasionally gave some reason to hope that its position was coming into line with that of other Federal courts. Cf., e.g., Federal Insurance Company v. Community State Bank, 905 F.2d. 112, 116 (5th Cir. 1990) (holding, under Louisiana law, that a contractor's failure to pay its subcontractors and complete the punchlist constituted a material breach of the contract by which the contractor forfeited all rights in the remaining contract funds). Nevertheless, the existence of Coconut Grove and General Casualty Company as unchallenged precedent created a split

between Federal jurisdictions which was recognized at least as early as two decades ago. See, Industrial Bank of Washington v. United States, 424 F.2d 932, 934 (D.D.C. 1970); and Great American Insurance Company v. United States, 492 F.2d 821, 828 n.4 (Ct.Cl. 1974). The present reaffirmation by the Fifth Circuit of the Coconut Grove and General Casualty Company decisions means not only that the split has never healed, but that today it is even deeper than before.

## II. THE RESOLUTION OF THE CONFLICT BETWEEN THE FIFTH CIRCUIT AND OTHER JURISDICTIONS IS A MATTER OF FEDERAL LAW AFFECTING IMPORTANT INTERESTS.

The matter of determining the priority of claims against Federal

contract funds is a matter of peculiarly Federal interest. It involves directly the interpretation of the Assignment of Claims Act, indirectly the interpretation of the Miller Act, and as a practical matter the application of a significant body of Federal law on which commercial sureties and commercial lenders ground their business practices and Government contract administrators frequently must base their payment decisions. Virtually every significant Federal construction contract requires a bond under the Miller Act. Many, if not most, contractors routinely borrow money in transactions secured by contract receivables. In every one of such contracts, there is a potential for a default and subsequent dispute over

the application of remaining contract funds.

Congress has attempted to create a specialized forum within a complete statutory scheme for resolving issues relating to Federal contracts. See, generally, Anthony and Smith, The Federal Court Improvement Act of 1982: Its Impact on the Resolution of Federal Contract Disputes, 13 PUBLIC CONTRACT LAW JOURNAL 201 (1982). Contractors, sureties and lenders doing business with the Federal Government look to the newly constituted Claims Court and the Court of Appeals for the Federal Circuit for guidance on issues affecting them in the administration of Federal Contracts. See, e.g., Cinelli, The United States Court of Appeals for the Federal Circuit: Government Contracts 1990

Summary, 40 THE AMERICAN UNIVERSITY LAW REVIEW 1117 (Spring 1991). According to the law as stated in the specialized jurisdiction of the Claims Court and Court of Appeals for the Federal Circuit, the surety should prevail in circumstances such as are involved in the present case.

III. THE POSITION OF THE FEDERAL CIRCUIT ON THIS MATTER IS CLEAR AND CLEARLY IN CONFLICT WITH THAT OF THE FIFTH CIRCUIT.

In the case of Reliance Insurance Company v. U.S., 15 Cl.Ct. 62 (1988), the Corps of Engineers refused to disburse contract funds as to which the contractor's surety, the contractor's assignee, and the IRS all asserted claims. The contractor itself was in bankruptcy and made no claim to the

funds. When the surety filed suit to recover the funds, the Government asserted a counterclaim for payment of the contractor's tax liability and the assignee intervened as an additional party plaintiff. The reported opinion sets forth the judgment of the Claims Court in resolution of the surety's motion for partial summary judgment against the assignee and the assignee's cross-motion for partial summary judgment against the surety. The Claims Court held, in a strong opinion, that after the Government recouped the taxes due it, the surety would be first in line for recovery of its losses on the bonded contract. Thus, on the present facts, Amwest Surety would clearly have prevailed had the action been initiated in the Claims Court, rather than in a

Bankruptcy Court within the Fifth Circuit's jurisdiction.

The Court of Appeals for the Federal Circuit, while it has not addressed a precisely similar situation, has left little doubt that it would reach the same conclusion as the Claims Court. In the case of Balboa Insurance Company v. United States, 775 F.2d 1158 (Fed. Cir. 1985), the Miller Act surety apprehended that it might be called upon to perform or make payment under its bond. The surety notified the Government, as the owner on the bonded contract, of the surety's concerns and requested that the Government withhold contract payments. The Government failed to do so. The Court of Appeals for the Federal Circuit concluded that a surety's interest in the bonded contract was substantial

enough to trigger a duty on the part of the Government to act with reasoned discretion to protect that interest. If the Government did not act with reasoned discretion, the Court held, the Government could be liable to the surety for amounts paid to the bonded contractor even when those payments would otherwise have been in accordance with the contract. Implicit in the Court's holding in Balboa was that the surety's interest in the contract funds superseded even the contractor's interest, once the contractor had failed to perform its obligations under the bonds. If the contractor had possessed a superior right to receive payment, of course, then the Government would have been fully protected in making payment to the contractor, and the Government

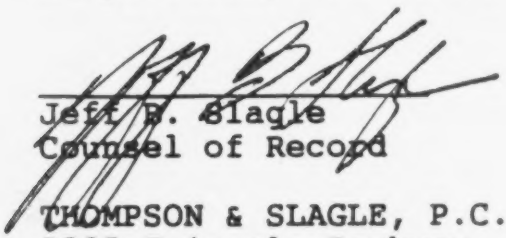
could not have had potential double liability to the surety. The interest of an assignee of the contractor could be no greater.

## CONCLUSION

The question presented involves the interpretation of Federal contract law. The interpretation of Federal contract law should be uniform throughout the various circuits. Inconsistent decisions amongst the circuits regarding the question presented will result in forum shopping, with the outcome of cases involving similar facts and issues depending on the particular Federal court that is hearing the case. Federal contract law should be uniform in its application. The present case represents a clear opportunity for the Supreme Court to resolve the long-

standing conflict between the Fifth Circuit and other jurisdictions by granting this Petition for Certiorari.

Respectfully submitted,



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## APPENDIX


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| Judgment of United States District Court, Eastern District of Louisiana entered on February 28, 1991 | 13a thru 14a |
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UNITED STATES COURT OF APPEALS
for the Fifth Circuit

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No. 91-3699
Summary Calendar

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IN THE MATTER OF

RIVER PRODUCTS, INC.,

Debtor,

UNITED FIDELITY & TRUST COMPANY,

Appellee,

VERSUS

AMWEST SURETY INSURANCE COMPANY,

Appellant.

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Appeal from the United States District Court
for the Eastern District of Louisiana
(91-CV-1303)
(February 5, 1992)

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Before JOLLY, DAVIS, and SMITH, Circuit Judges.[1]

PER CURIAM:

The district court correctly concluded that this appeal is governed by the following two decisions of this court: Coconut Grove Exchange Bank v. New Amsterdam Casualty Co., 149 F.2d 73 (5th Cir. 1945), and General Casualty Co. v. Second Nat'l Bank of Houston, 178 f.2d 679 (5th Cir. 1950). Accordingly, the judgment of the district court is AFFIRMED.

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[1]Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the Court has determined that this opinion should not be published.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

IN RE:
RIVER PRODUCTS, INC.
Debtor,

CIVIL ACTION

UNITED FIDELITY
AND
TRUST COMPANY,
Plaintiff,

NO. 91-1303

VERSUS

RIVER PRODUCTS,
INC., AMWEST
SURETY INSURANCE
COMPANY, and THE
UNITED STATES OF AMERICA,
Defendants.

SECTION E/1

ORDER AND REASONS

This is an appeal from the judgment of the Bankruptcy Court in an interpleader action concerning the ownership of funds due the debtor from the United States under a certain contract between the U.S. Army Corps of Engineers and the Debtor. That judgment

directed that the monies due the debtor be paid to Amwest Surety Insurance Company ("Amwest") as surety, in preference to the claim of United Fidelity & Trust Company ("Fidelity") the assignee of the contract. Although the Internal Revenue Service ("IRS") has asserted a claim to a portion of the funds, neither Amwest nor Fidelity has asserted that its interest is superior to that of the IRS. The funds have been placed in the registry of the Court. Jurisdiction is not disputed and this Court reviews the matter de novo.

This action involves the ranking of the claims of Fidelity and Amwest against a fund consisting of contract payments withheld by the United States on a dredging contract (the "Columbus Lake Contract") between the Army Corps

of Engineers (the "Corps") and the Debtor, River Products. Fidelity is the assignee, pursuant to the Assignment of Claims Act, 31 U.S.C. § 3727, and 41 U.S.C. § 15, of the contract payments owed River Products under the Columbus Lake Contract. In connection with the Assignment, Fidelity provided interim financing to River Products to perform the Columbus Lake Contract. Amwest is a surety who, pursuant to the Miller Act, 40 U.S.C. § 270a, issued a payment and performance bond in favor of the United States to secure the performance by River Products of the Columbus Lake Contract. Several months after River Products commenced work on the contract, and subsequent to the Assignment, Amwest made payment under the bond to certain suppliers and laborers for work that

River Products had contracted for in the course of its performance on the contract but had failed to pay.

Appellant contends that:

(1) The bankruptcy court erred in concluding as a matter of law that Amwest, as a Miller Act Surety, had a superior right vis-a-vis Fidelity, as an assignee under the Assignment of Claims Act, to the contract proceeds owed by the United States under a government contract with the debtor, River Products.

(2) The bankruptcy court erred in failing to find that as a matter of law Amwest was estopped from asserting a superior priority vis-a-vis Fidelity to the contract proceeds owed by the United States, in the event Amwest otherwise held a superior right.

This second contention was not addressed by the Bankruptcy Court, and for the following reasons need not be addressed by this Court.

The parties have submitted very professional and thorough memoranda on the matter. There is no material dispute as to the Bankruptcy Court's stated findings of fact and this Court, accordingly, accepts them. The thrust of Fidelity's appeal is to the effect that in its conclusions of law the Bankruptcy Court chose not to follow Fifth Circuit precedent and instead relied on authority mostly from the Court of Claims stating "... pursuant to the weight of the law on competing rights such as those involved here and in conformance with what this Court

considers the better position in such circumstances ..."

Review of the matter indicates that in arriving at its conclusions of law, the Bankruptcy Court chose not to follow the law of the Fifth Circuit as announced in Coconut Grove Exchange Bank v. New Amsterdam Casualty Co., 149 F.2d 73 (5th Cir. 1945), and General Casualty Co. v. Second National Bank of Houston, 178 F.2d 679 (5th Cir. 1949). Instead it applied the rule of law originated in the Court of Claims, e.g., Royal Indemnity Co. v. United States, 117 Ct. Cl. 736, 755 (U.S. Ct. Cl. 1950), wherein the Court of Claims held that the surety's equitable right of subordination outranks the assignee's legal rights under the assignment.

In Coconut Grove Exchange Bank, 149 F.2d at 73, the Fifth Circuit expressly held that the Assignment of Claims Act gives the assignee under the Act an interest in withheld government contract payments which is superior to the rights of the Miller Act surety who provided the payment and performance bond for the contract. The Court held as follows:

> The amendment expressly made it lawful for the Contractor to assign the proceeds of his contract to a bank, whereupon all the proceeds shall be paid to that bank, and since it permitted that to be done but did not permit as assignment to a surety company, the amendment did definitely and incidentally affect the rights of the bank and of the surety. But a surety in writing such a bond does so in the light of the amendment and will be held to have accepted its applicable provisions.
>
> We hold, therefore, that the 1940 amendment of Section 203, while being primarily for

> the protection of the United States and not for the regulation of the equities of the claimants, as between themselves, nevertheless, did incidentally affect the rights between the assignee of contractor and the surety so as to make assignments to a bank from a contractor for the purposes of the contract valid ...

Id. at 78-79. In recognizing the assignee's superior interest, the Fifth Circuit indicated that fairness dictated that the assignee/lender, rather than the surety, be given superior rights to progress payments owed under a government contract since the lender's monies had been applied to satisfy obligations arising under the contract. Accordingly, the Court of Appeal reasoned that money from the lender satisfied obligations that the surety would otherwise have incurred had the

surety taken over performance of the contract.

In General Casualty Co., 178 F.2d at 679, the Fifth Circuit revisited the issue raised in Coconut Grove and reaffirmed its earlier position. However, the Court did recognize that the surety may have a superior position in the retainage held by the United States.[1]

It is axiomatic that this Court must apply the law of the Fifth Circuit. Accordingly, the judgment of the Bankruptcy Court will be **REVERSED**, the cross motions for summary judgment of both Fidelity and Amwest will each be **GRANTED IN PART** and **DENIED IN PART** and

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[1]The retainage in the matter sub judice was placed in the Court's registry together with contract proceeds.

judgment will be entered recognizing Fidelity's priority right to the contract proceeds and Amwest's priority right to the retainage funds, all subject to prior disposition of the claim of the Internal Revenue Service.

New Orleans, Louisiana, this 31st day of July, 1991.

MARCEL LIVAUDAIS, JR.
United States
District Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF LOUISIANA

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|---|---|
| IN THE MATTER OF | BANKRUPTCY NUMBER |
| **RIVER PRODUCTS, INC.** | **89-13649B** |
| DEBTOR | |
| **UNITED FIDELITY & TRUST COMPANY** | ADVERSARY NUMBER |
| PLAINTIFF | **90-1021B** |
| V. | |
| **RIVER PRODUCTS, INC., AMWEST, INC. and UNITED STATES OF AMERICA** | |
| DEFENDANTS | CHAPTER 11 |

**JUDGMENT**

For the reasons assigned in the foregoing Findings of Fact and Conclusions of Law entered herein by the Court this date,

IT IS ORDERED that the Motion for Summary Judgment filed by United

Fidelity & Trust Company be, and it is hereby, DENIED.

IT IS FURTHER ORDERED that the Motion for Summary Judgment filed by Amwest, Inc. be, and it is hereby GRANTED.

IT IS FURTHER ORDERED that the sum of $143,309.00 deposited in the registry of this Court be released to Amwest, subject to the claim of the Internal Revenue Service.

New Orleans, Louisiana, February 28, 1991.

T. M. BRAHNEY, III
U. S. BANKRUPTCY
JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF LOUISIANA

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|---|---|
| IN THE MATTER OF | BANKRUPTCY NUMBER |
| RIVER PRODUCTS, INC. | 89-13649B |
| DEBTOR | |
| UNITED FIDELITY & TRUST COMPANY | ADVERSARY NUMBER |
| PLAINTIFF | 90-1021B |
| V. | |
| RIVER PRODUCTS, INC., AMWEST, INC. and UNITED STATES OF AMERICA | |
| DEFENDANTS | CHAPTER 11 |

**FINDINGS OF FACT AND CONCLUSIONS OF LAW**

This matter came before the Court on a Motion for Summary Judgment to Determine Ranking Vis-A-Vis Amwest Surety Insurance Company ("Amwest") filed by United Fidelity & Trust Company ("United"), a creditor of the Debtor,

River Products, Inc. The underlying adversary proceeding, seeking a turnover of certain funds, was filed by United on January 23, 1990. In response to United's Motion, Amwest filed a Cross-Motion for Summary Judgment of its own. A hearing was held on these Motions on October 9, 1990, at which time the Court heard the statements of counsel for United and for Amwest. Upon consideration of these statements, the memoranda filed, the record in the case and the applicable law, the Court makes the following Findings of Fact and Conclusions of Law.

## FINDINGS OF FACT

1. The Debtor is a Louisiana corporation in the business of commercial dredging. On April 3, 1989, the Debtor and the United States Army

Corps of Engineers ("the Corps") entered into a dredging contract, Contract No. DACW01-89-C-0078 ("the Columbus Lake Contract").

2. As required of government contractors under the Miller Act, 31 U.S.C. §3727 (1982), the Debtor obtained a payment and performance bond (No. 1171295) from Amwest, with Amwest as the surety, the Debtor as the principal and the Corps as the obligee. This bond was issued on March 30, 1989. On March 27, 1989, prior to the issuance of the bond, Amwest and the Debtor entered into a General Indemnity Agreement, which contained provisions for assignment of the contracts of the Debtor. This Agreement was, however, never recorded.

3. On April 17, 1989, the Debtor executed an assignment of the payments

due or to become due on the Columbus Lake Contract to United. A Notice of Assignment was sent to the Corps by United and was acknowledged as received on May 10, 1989.

4. Work on the Columbus Lake Contract was completed by September 14, 1989, at which time the Corps owed the Debtor $131,334.30 in progress payments and $12,075.00 in unpaid retainage. However, the Debtor failed to pay all of its laborers and suppliers on the contract. As of October 4, 1990, Amwest had paid approximately $150,204.00 in settlement of claims against Bond No. 1171295.

5. On September 26, 1989, the Debtor filed a Petition for Relief under Chapter 11 of the Bankruptcy Code.

6. On July 20, 1990, this Court ordered the United States to deposit the sum of $143,309.30, representing monies due to the Debtor on the Columbus Lake Contract, into the registry of the Court.

## CONCLUSIONS OF LAW

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §1334. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(K).

2. United asserts that, since the purported assignment of the Columbus Lake Contract to Amwest in the Indemnity Agreement was never recorded, it was never perfected and the assignment United holds is superior to any of Amwest. In support of its argument, United cites a 1945 Fifth Circuit case, Coconut Grove Exchange Bank v. New

Amsterdam Casualty Co., 149 F2d 73 5th Cir. 1945). In that case, a bank which had loaned money to a government contractor and had obtained as security an assignment of contract proceeds, had been paid approximately $12,000.00 by the government under its assignments. However, the surety on the contract asserted that it was entitled to the contract proceeds under its surety bond and an assignment. The court held that the 1940 amendments to the Assignment of Claims Act did not allow a surety to receive an assignment of government contract proceeds and, therefore, since the bank held the only valid assignment, and the surety had no equitable claim to the money since the proceeds of the bank loan had gone to pay the contractor's labor and materials, the bank had the

superior right to the proceeds. A subsequent case, General Casualty Co. v. Second Nat. Bank of Houston, 178 F.2d 679 (5th Cir. 1950), was decided similarly.

3. Amwest asserts that its superior right to the contract proceeds is an equitable right attaching when the performance bond was given, with the right to assert this equity arising from Amwest's payments under the bond. Indeed, this position is supported by the majority of recent cases on the subject. Most of these cases come from the Court of Claims, which is the court most familiar with government contract cases. For example, as early as 1950, in Royal Indemnity Co. v. United States, 117 Ct.Cl. 736, 755 (U.S. Ct.Cl. 1950), the court stated that "[t]he equity of

the surety company arose at the time of the giving of the bond. The bank took its assignment with knowledge of and subject to the equity of the surety. The Assignment Act of 1940 did not cut off this equity." The court went on to note that the equity right became assertable when the surety paid under the bond and that the bank with an assignment from the contractor had an inferior right to contract proceeds. Id.

Subsequent cases have held similarly. Those cases include: National Surety Corp. v. United States, 133 F. Supp. 381 (U.S. Ct. Cl. 1955) (citing an 1896 U.S. Supreme Court case, Prairie State Nat. Bank of Chicago v. United States, 164 U.S. 227, 17 S.Ct. 142, 41 L.Ed. 412 (1896), which held that a surety is equitably subordinated

to the United States when it gives a bond on a government contract and, if the surety has to pay on the bond, its claim to the contract monies arises before, and is superior to, an assignee bank); Industrial Bank of Washington v. United States, 424 F2d 932 (D.C. Cir. 1970); Great American Insurance Co. v. United States, 492 F.2d 821 (U.S. Ct. Cl. 1974); and Reliance Insurance Co. v. United States, 15 Cl.Ct. 62 (U.S. Ct. Cl. 1988).

This case recently reiterated the position that the rights of a surety grow out of its liability on the bond given and attach from the date of the contract or, at the latest, from the date of the giving of the bond. Reliance, 15 Cl.Ct. at 65-66. Furthermore, the rights of an assignee

bank arise from the date of the filing of the required Notice of Assignment and that bank is charged with knowledge that the surety bond is required of government contractors. Id. at 66. Also, the courts in Industrial and Great American, cited above, expressly noted the decisions of the Fifth Circuit in Coconut Grove and General Casualty and declined to follow them, considering that a contrary result would have followed, even in the Fifth Circuit cases, where the contract proceeds were still in the possession of the government.

4. In the instant case, the Columbus Lake Contract was dated April 3, 1989. Bond No. 1171295 was issued by Amwest on March 30, 1989. The Assignment to United was dated April 17,

1989. There are not disputes as to these material facts. Consequently, pursuant to the weight of the law on competing rights such as those involved here, and in conformance with what this Court considers the better position in such circumstances, the superior right to the proceeds now being held in the Court registry is that of Amwest. Accordingly, the Motion for Summary Judgment filed by United will be denied, and the Motion for Summary Judgment filed by Amwest will be granted. An appropriate Judgment will be entered.

New Orleans, Louisiana, February 28, 1991.

T. M. BRAHNEY, III
U. S. BANKRUPTCY
JUDGE

31 U.S.C. §3727 "Assignments of Claims

(a) In this section, "Assignment" means- (1) a transfer or assignment of any part of a claim against the United States Government or of an interest in the claim; or (2) the authorization to receive payment for any part of the claim.

(b) An assignment may be made only after a claim is allowed, the amount of the claim is decided, and a warrant for payment of the claim has been issued. The assignment shall specify the warrant, must be made freely, and must be attested to by 2 witnesses. The person making the assignment shall acknowledge it before an official who may acknowledge a deed, and the official shall certify the assignment, The certificate shall state that the official completely explained the assignment when it was acknowledged. An assignment under this subsection is valid for any purpose.

(c) Subsection (b) of this section does not apply to an assignment to a financing institution of money due or to become due under a contract providing for payments totaling at least $1,000 when- (1) the contract does not forbid an assignment; (2) unless the contract expressly provides otherwise, the assignment- (A) is for the entire amount not already paid; (B) is made to only one party, except that it may be made to a party as agent or trustee for more

than one party participating in the financing; and (C) may not be reassigned; and (3) the assignee files a written notice of the assignment and a copy of the assignment with the contracting official or the head of the agency, the surety on a bond on the contract, and any disbursing official for the contract..."

40 U.S.C. §270a "Bonds of contractors of public buildings or works

(a) Type of bonds required. Before any contract, exceeding $25,000.00 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor": (1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States. (2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000.000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than

5,000,000 the said payment bond shall be in the sum of $2,500,000."

41 U.S.C. §15 "Transfers of contracts; assignments of claims; set-off against assignee

No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

The provisions of the preceding paragraph shall not apply in any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution, including any Federal lending agency: Provided,...

4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with (a) the contracting officer or the head of his department or agency; (b) the surety or sureties upon the bond or bonds, if any, in connection with such contract; and (c) the disbursing officer, if any, designated in such contract to make payment."

Supreme Court, U.S.
FILED
JUN 4 1992
OFFICE OF THE CLERK

(2)

No. 91-1777

In The

# Supreme Court of the United States

October Term, 1991

AMWEST SURETY INSURANCE COMPANY,

*Petitioner,*

versus

UNITED FIDELITY & TRUST CO.,

*Respondent.*

**Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit**

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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## STATEMENT OF ISSUES PRESENTED

1. Whether the Assignment of Claims Act, 31 U.S.C. § 3727 and 41 U.S.C. § 15, grants the assignee thereunder a superior right to assigned contract payments (exclusive of retainage) owed by the United States vis-a-vis a Miller Act Surety, 40 U.S.C. § 270a, who issued payment and performance bonds to secure the performance of the contract.

2. Whether a Miller Act Surety has stated a case for equitable subrogation vis-a-vis an assignee of contract payments owed by the United States where the monies lent by the assignee to the contractor were used by the contractor for performance of the contract and therefore relieved the Miller Act Surety of obligations it otherwise would have incurred under its payment and performance bonds.

3. Whether a Miller Act Surety is estopped from asserting a priority vis-a-vis an assignee of contract payments owed by the United States where the Miller Act Surety has acquiesced in the assignment of the contract payments by the contractor to the assignee and benefitted from the continued lending by the assignee in reliance upon the assignment.

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## STATEMENT OF THE CASE

### A. Introduction.

This action involves the ranking of the claims of United Fidelity & Trust Company ("Fidelity") and Amwest Surety Insurance Company ("Amwest") against a fund consisting of contract payments withheld by the United States on a dredging contract (the "Columbus Lake Contract") between the Army Corps of Engineers (the "Corps") and River Products, Inc. ("River Products"), a debtor in bankruptcy. There is not any dispute as to the retainage portion of the funds owed on the Columbus Lake Contract. Fidelity is the assignee, pursuant to the Assignment of Claims Act, 31 U.S.C. § 3727, and 41 U.S.C. § 15, of the contract payments owed River Products under the Columbus Lake Contract. In connection with River Product's assignment of the contract payments to Fidelity (the "Assignment"), Fidelity provided interim financing to River Products to perform the Columbus Lake Contract. Amwest is a surety who, pursuant to the Miller Act, 40 U.S.C. § 270a, issued payment and performance bonds in favor of the United States to secure the performance by River Products of the Columbus Lake Contract.

### B. Statement of Facts.

River Products and the Corps entered into the Columbus Lake Contract on April 3, 1989. As a requisite for the Columbus Lake Contract, on March 30, 1989, Amwest issued payment and performance bonds with Amwest as surety and River Products as principal and the Mobile

District Corps of Engineers as obligee. Prior to the issuance of the payment and performance bonds, River Products and Amwest entered into a General Indemnity Agreement (the "Indemnity Agreement"), wherein River Products assigned to Amwest all its right, title and interest to the Columbus Lake Contract payments. However, this Indemnity Agreement was not recorded to notify third parties of Amwest's interest in the Columbus Lake Contract in accordance with Louisiana law.

River Products commenced performance on the Columbus Lake Contract on or about April 3, 1989. On April 17, 1989, River Products executed an assignment of the payments due or to become due on the Columbus Lake Contract in favor of Fidelity as security for the sums to be loaned by Fidelity in connection with River Products' performance of the Columbus Lake Contract. Fidelity mailed the Notice of Assignment to the Disbursing Officer for the Columbus Lake Contract and the Contracting Office for the Corps, and in due course the Notices were acknowledged. In consideration of the Assignment, Fidelity provided interim financing to River Products for use by River Products towards fulfillment of its obligations under the Columbus Lake Contract.[1]

Fidelity, Amwest and River Products reached an impasse as of July 25, 1989, regarding the continued financing of the Columbus Lake Contract.[2] The uncontroverted evidence presented by Fidelity demonstrated

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[1] Record Excerpt of Appellee, United Fidelity & Trust Company (hereinafter referred to as Appellee R.E.) No. 4.

[2] Appellee R.E. No. 7; Appellee R.E. No. 8.

that Fidelity continued to extend credit to River Products only after Amwest had assured Fidelity that Amwest would not be required to perform on its bond if Fidelity provided additional financing to River Products.[3] Based on Amwest's assurances, Fidelity lent substantial additional monies to River Products that remain unpaid and are part of the claim which Fidelity now asserts. River Products continued its work on the Columbus Lake Contract and completed the work on September 14, 1989 utilizing funds from Fidelity.[4] All loan proceeds from Fidelity were in fact used by River Products in connection with the Columbus Lake Contract.[5]

Amwest ultimately paid under its payment bond certain suppliers and laborers for work that River Products had contracted for in the course of its performance on the Columbus Lake Contract but had failed to pay. River Products was unable to pay either Fidelity or Amwest the sums due them. On September 26, 1989, River Products filed a voluntary petition under Chapter 11 of the Bankruptcy Code. In connection with the bankruptcy case, Fidelity filed an adversary proceeding against River Products, Amwest and the United States of America seeking to have the Bankruptcy Court determine the priority of its security interest in the payments due by the Corps under the Columbus Lake Contract. In connection with the adversary proceeding, the Corps deposited $318,409.30 into the Registry of Court as the total sum due and owing under the Columbus Lake Contract. Of

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[3] Id.

[4] Appellee R.E. 5.

[5] Id.

this amount, $12,075.00 represented the retained portion or retainage withheld pursuant to the Columbus Lake Contract by the United States as security for the complete performance of the Columbus Lake Contract by River Products.[6]

### C. The Rulings of the Courts Below.

The case was decided on opposing motions for summary judgment; there were not any contested issues of fact. Fidelity contended that as a matter of law it had a superior right to the contract payments under the Assignment of Claims Act since it had received its assignment prior to River Product's default under the Columbus Lake Contract. Fidelity further contended that its claim outranked Amwest's equitable subrogation claim since Amwest did not undertake to complete the project and the monies lent by Fidelity had been used by River Products in the performance of the Columbus Lake Contract. Finally, Fidelity urged that Amwest was estopped to challenge Fidelity's superior claim because Amwest had consented to the assignment and encouraged additional

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[6] Appellee R.E. No. 5; Appellee R.E. No. 6. Under a typical government construction contract, the contract provides that the government will "retain" a certain percentage of the contract price until final completion of the contract by the contractor. As the contractor completes portions of the project, the government makes periodic progress payments to the contractor, or his assignee, but the government is entitled to retain a percentage of the contract price, specified in the contract, to insure the contractor's complete performance of the contract and to protect the government from any damages arising out of the contractor's non-performance. This portion is commonly referred to as the "retainage".

lending by Fidelity with assurances that it would not perform on its bond if additional financing were made available by Fidelity. Contrariwise, Amwest asserted that its claim, based on its equitable right of subrogation, was superior to Fidelity's legal rights under the assignment because the surety bond was issued prior to the assignment.

The Bankruptcy Court noted that Amwest's payment and performance bonds were issued on March 30, 1989, prior to the Assignment made to Fidelity on April 17, 1989. Based on this fact alone, the Bankruptcy Court held that Amwest had a superior right to the funds. The District Court reversed, acknowledging the controlling authority of *Coconut Grove Exchange Bank v. New Amsterdam Casualty Co.*, 149 F.2d 73 (5th Cir. 1945), and *General Casualty Co. v. Second National Bank of Houston*, 178 F.2d 679 (5th Cir. 1949). *Coconut Grove* and *General Casualty* provide that under the Assignment of Claims Act an assignee's legal right to contract payments owing on a Government contract, except for the retained portion withheld under the contract as security for complete performance (the "retainage"), is superior to the surety's equitable right to those payments where the funds loaned to the contractor by the assignee are used in the performance of the contract and the surety did not undertake to complete the contract. Accordingly, the District Court entered judgment in favor of Fidelity recognizing its priority over Amwest to the contract proceeds held in the Registry of the Court, except as to the retainage sum of $12,075.00 owed on the contract, all subject to the disposition of the claim of the Internal Revenue Service for unpaid taxes owed by River Products. Because of its

reliance on *Coconut Grove* and *General Casualty*, the District Court did not address Fidelity's contention that Amwest was estopped to deny the priority of Fidelity's claim. The Fifth Circuit affirmed the District Court in a *per curiam, unpublished* opinion, holding that the District Court had correctly applied *Coconut Grove* and *General Casualty* to the facts. This opinion did not address the estoppel arguments of Fidelity.

## REASONS FOR DENYING THE WRIT

Amwest requests this Court to grant a writ of certiorari based on a purported inconsistency between the Fifth Circuit's decisions in *General Casualty* and *Coconut Grove* and this Court's opinions in *Prairie State Bank of Chicago v. United States*, 164 U.S. 227, 17 S. Ct. 142, 41 L. Ed. 412 (1896), and *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S. Ct. 233, 9 L. Ed. 190 (1962). Amwest also asserts that this Court should grant certiorari based on the purported disagreement among the circuits as to the competing rights of an assignee and a surety to progress payments owed by the government to a contractor which is in default of its obligation to pay suppliers. This Court should deny the petition for writ of certiorari because *Coconut Grove* and *General Casualty* are consistent with Supreme Court authorities and there is no conflict among the courts of appeal.

### 1. The Fifth Circuit Jurisprudence Is Consistent with Supreme Court Authorities.

In *Coconut Grove*, a Miller Act surety sued an assignee under the Act for recovery of payments made to it by the United States on a bonded government contract. In holding that the assignee should receive the payments from the government in preference over the surety, the Fifth Circuit noted that the Assignment of Claims Act of 1940 was intended to encourage private financing of government contracts "and to make it so contractors could borrow money from banks and other lending institutions so as to thereby promote the national defense . . . " *Coconut Grove*, 149 F.2d at 77.[7] The Fifth Circuit then noted that, consistent with the Assignment of Claims Act, the rights of the surety are subordinate to those of the assignee:

> The [Assignment of Claims Act] expressly made it lawful for the Contractor to assign the proceeds of his contract to a bank, whereupon all the proceeds shall be paid to that bank, and since it permitted that to be done but did not permit an assignment to a surety company, the [Assignment of Claims Act] did definitely and incidentally affect the rights of the bank and of the surety.

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[7] The Assignment of Claims Act of 1940 was an amendment to the federal anti-assignment statutes which made an assignment of government contract payments null and void. The original heading of the amendment was as follows: "To assist in the national defense program by amending sections 3477 and 3737 of the Revised Statutes to permit the assignment of claims under public contract." 54 Stat. 1029.

*Id.* at 78-79. Accordingly, the Fifth Circuit held that under the Assignment of Claims Act the assignee's claim to the contract payments outranked the surety's claim.

In *Coconut Grove* the Fifth Circuit also concluded that, "irrespective of the effect of said Section 203, as amended, [the Assignment of Claims Act]" the surety was required, in order to state and make out a case for equitable subrogation vis-a-vis the assignee, "to allege and to prove that the funds advanced by the Bank to the Contractor were diverted from purposes essential to the performance of the contract." In recognizing the assignee's superior interest, the Fifth Circuit emphasized that *equity* dictated that the assignee/lender, rather than the surety, be given superior rights to progress payments owed under a government contract since the lender's monies had been applied to satisfy obligations arising under the contract which the surety would otherwise have incurred had the surety taken over performance of the contract.

> But no superior equity in the Surety will appear unless it shows that the money lent by the Bank was diverted or used for purposes outside the contract, for if the money lent was applied to the payment of labor and materials used in the contract, thereby discharging obligations for which the Surety would otherwise have been liable, the Surety was in no wise injured by the transaction.

*Id.* at 78.

In *General Casualty Co.*, the Fifth Circuit revisited the issue raised in *Coconut Grove* and reaffirmed its position.

The court of appeals rearticulated the reasons it had set forth in *Coconut Grove* for concluding that the Assignment of Claims Act contemplated that an assignment made thereunder prior to the contractor's default would be free and clear of any liens. 178 F.2d at 680. However, the Fifth Circuit recognized that the surety had superior rights vis-a-vis the assignee to the retained portion withheld by the government under the contract as security for completion of the contract.

> But the ten per cent retained each month under the contract was held by the owner for the protection of itself and the surety. In these retained percentages, the contractor could give no one a right superior to that of the owner and the surety.

178 F.2d at 680. Thus, Fidelity in the instant case did not assert a superior claim to the retainage portion of the funds.

The reasons cited by the Fifth Circuit in *Coconut Grove* and *General Casualty* for ranking an assignee's legal claim to progress payments ahead of the equitable claim of a surety are fundamentally sound and consistent with this Court's rulings both before and after *Coconut Grove* and *General Casualty*. In making its ruling in *General Casualty*, the Fifth Circuit cited to and fully adopted the principles established by this Court in *Prairie State Bank, supra*. 178 F.2d 680. In *Prairie State Bank* this Court addressed the respective equitable rights of a purported assignee and a surety to the *retained portion* held by the United States on a government construction contract as security for complete performance by the contractor. As in *Prairie State Bank*, the Fifth Circuit held in *General*

*Casualty* that the surety's claim to the retained percentage was inviolate and could not be assigned to the prejudice of the surety.[8] Additionally, this Court's opinion in *Prairie State Bank* was decided several years before the amendment to the Assignment of Claims Act, which specifically authorized the assignment of claims against the government in favor of a financing institution. Accordingly, *Prairie State Bank* does not address the issues in this case.

*Coconut Grove, General Casualty* and the instant case are also consistent with *Pearlman v. Reliance Ins. Co., supra,* which was decided after *General Casualty*. In *Pearlman,* the Supreme Court held that a bankruptcy trustee, as a hypothetical judgment lien creditor, did not acquire superior rights vis-a-vis a Miller Act surety to the *retained portion* withheld by the government under a contract as security for complete performance by the Contractor. Since *General Casualty, Coconut Grove* and the instant case only involve the competing rights of an assignee prior to default and a surety, *Pearlman* is not implicated. *Pearlman* did not address the status of an assignee under the Assignment of Claims Act. Additionally, since *General Casualty* holds that a surety's rights to the *retained portion* are inviolate, even vis-a-vis an assignee prior to default, *General Casualty* is clearly not in conflict with any principle set forth in *Pearlman* and indeed presaged *Pearlman*.

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[8] Consistent with *Prairie State Bank,* the District Court and the Fifth Circuit in the instant case recognized Amwest's superior claim to the retainage.

### 2. The Fifth Circuit's Ruling Does Not Place It In Conflict With Other Courts of Appeal

Rule 10 of the Rules of the Supreme Court provides that this Court will consider review of a case on a writ of certiorari when, *inter alia,* a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeal. Amwest contends that a decisive conflict exists among three circuits as to the legal ranking of competing claims asserted against the government by an assignee under the Assignment of Claims Act and a Miller Act Surety for progress payments owed by the government to a contractor for work performed under a completed government contract.

Amwest asserts that *Coconut Grove* and *General Casualty* are in conflict with the opinion of the Court of Appeals for the D.C. Circuit in *Industrial Bank of Washington v. United States,* 424 F.2d 932 (D.C. Cir. 1970). However, in *Industrial Bank* the facts and equities were significantly different from those at issue in *Coconut Grove* and *General Casualty.* The Fifth Circuit cases are based on circumstances where the contractor has completed a government contract using funds lent by the assignee. In *Industrial Bank* the assignee asserted its claim vis-a-vis the surety through a contractor who was terminated prior to completing the job. The contractor in fact owed the government money for extra payments made by the government, for which the surety was liable, to procure another contractor to finish the project. Unlike the assignee/lender in *General Casualty,* the assignee/lender in *Industrial Bank* had not lent funds which had been used by the

contractor to complete the contract and avoided payments by the surety which it would have otherwise made under its bond had the surety completed the contract. In addressing the assignee's claim to priority under the Assignment of Claims Act, the D.C. Circuit concluded that:

> The words of the act are not properly applied if, *following a termination for default,* they are construed to give the bank as assignee of the contractor a right to funds in the hands of the Government which are needed for completion of the contract.

424 F.2d at 934 (emphasis added). Accordingly, *Industrial Bank* is not in conflict with *Coconut Grove* and *General Casualty*.

Amwest additionally contends that *Coconut Grove* and *General Casualty* are in conflict with *Balboa v. United States*, 775 F.2d 1158 (Fed. Cir. 1985), a case in which the Assignment of Claims Act was not even discussed, much less at issue. In *Balboa* a Miller Act surety had issued payment and performance bonds in favor of the government on a construction contract. During the contractor's performance of the contract, the surety notified the government that the contractor was in default of its obligations under the contract and surety bonds on account of the contractor's failure to pay its subcontractors and suppliers, and the surety requested that the government withhold the progress payments owed to the contractor for completed work. However, the government paid the contractor notwithstanding the surety's request. The surety sued the government for wrongfully paying the contractor in light of its notice of the contractor's default

and the surety's request that the government withhold payment. The Federal Circuit concluded that in such a situation the government is a stakeholder in a dispute between the surety and the contractor and that, as a stakeholder, the government has a "duty to act with reasoned discretion when a Miller Act Surety alleges that the contractor has breached the contract by defaulting under its bonds."

Although *Balboa* did not address any issue arising under the Assignment of Claims Act or its relationship to the Miller Act, Amwest urges that *Balboa* is inconsistent with *Coconut Grove* and *General Casualty* by implication. Amwest points out that *Balboa* is premised on the Federal Circuit's determination that a surety's interest in a contract payment owed on a bonded government contract is superior to the contractor's interest once the contractor has defaulted on its obligations under the contract and surety bonds. Based on this premise, Amwest argues that it necessarily follows that an assignee's rights, being derivative of the contractor's rights, are inferior to a surety's rights to the contract payments and that *Balboa* is therefore inconsistent with *Coconut Grove* and *General Casualty*.

Amwest's contention that *Balboa* is in conflict with *Coconut Grove* and *General Casualty* is erroneous. In *Balboa*, the Federal Circuit did not address the central issue in *Coconut Grove*, *General Casualty*, and the instant case: whether the surety's equitable right of subrogation is superior to the legal rights of an assignee under the Assignment of Claims Act when the assignee has loaned the contractor the very funds which the contractor has used to pay for the labor and supplies required by the

contract, all to the benefit of the surety. Moreover, like *Balboa*, both *Coconut Grove* and *General Casualty* recognize that the surety has an equitable right of subrogation to the contract payments which outranks the claim of the contractor. However, in *Coconut Grove* and *General Casualty*. the Fifth Circuit recognized that a Miller Act surety's claim to contract payments owed to a contractor in default of the contract, while superior to that of the contractor, is inferior to the assignee's claim.

Amwest finally asserts that the decision of the United States Claims Court in *Reliance Ins. Co. v. United States*, 15 Cl. Ct. 62 (1988), is contrary to the principles established in *General Casualty* and *Coconut Grove*. Although the Claims Court ruled in favor of the surety in *Reliance*, as opposed to the assignee, the Claims Court specifically noted that there was no evidence before it that the assignee had loaned the contractor any monies for use in the contract. 15 Cl. Ct. at 65. In this regard, *Reliance* is clearly distinguishable from *Coconut Grove* and *General Casualty*. Moreover, in *Reliance* the surety, not the assignee, financed the completion of the contract. 15 Cl. Ct. at 63. The facts of *Coconut Grove* and *General Casualty* are exactly the converse.[9]

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[9] If *Reliance* were inconsistent with *Coconut Grove* and *General Casualty*, a conflict between the Claims Court and the Fifth Circuit Court of Appeals would not constitute a conflict between the courts of appeal. The Claims Court is merely a trial court. 28 U.S.C. § 157. The decisions of the Claims Court are appealable to the United States Court of Appeal for Federal Circuit. 28 U.S.C. § 1295(a)(3). Moreover, the Claims Court is an Article I court and lacks the full authority of an Article III

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## CONCLUSION

Since the jurisprudence of the Fifth Circuit Court of Appeals relating to the competing rights of an assignee and surety to progress payments withheld on a completed government contract is consistent with all decisions of this Court and is not in conflict with any decision of another court of appeals, this Court should deny the petition for writ of certiorari.

Respectfully submitted,

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court. *Id.* Accordingly, a decision of the Claims Court will not, absent other compelling reasons, justify the grant of a writ of certiorari to review a decision of the Fifth Circuit.